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In the Supreme Court of the United States

OCTOBER TERM, 1979

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, PETITIONER

v.

INVESTMENT COMPANY INSTITUTE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

REPLY BRIEF FOR THE PETITIONER

WADE H. MCCREE, JR.
Solicitor General

STEPHEN M. SHAPIRO
Assistant to the Solicitor General

Department of Justice
Washington, D.C. 20530
(202) 633-2217

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REPLY BRIEF FOR THE PETITIONER

1. Respondent's brief confuses both the scope of the activities authorized by the Board's regulation and the legal basis for the Board's action.[1] It therefore may be useful at the outset to summarize the activities that have been authorized by the Board and to set forth once again the basic elements of the statutory scheme.

a. Although respondent's brief may leave a different impression, neither a bank holding company nor any of its subsidiaries operating in the manner authorized by the Board's regulation would hold an equity interest in a closed-end investment company, participate in market-

[1] The Board's regulation and interpretive ruling permit a bank holding company or its non-bank subsidiary to render investment advice to and, subject to appropriate safeguards and restrictions, also to organize, sponsor, manage and control a closed-end investment company. 12 C.F.R. 225.125(c)-(i). Rendering investment advice to investment companies is an appropriate activity for a bank holding company, and respondent does not contend otherwise. Pet. App. 8a n.13. The dispute here therefore concerns solely the propriety of a holding company's organization, sponsorship, management and control of a closed-end investment company.

ing the investment company's securities to the public, or otherwise assume any financial risks with respect to the operations of the investment company. A bank holding company desiring to "sponsor" a closed-end investment company pursuant to the Board's regulation normally would proceed by creating an investment advisory subsidiary and filing with the Board a notice of its proposed operations. If the Board did not object within 45 days (see 12 C.F.R. 225.4(b)(1)), the subsidiary next would have to register as an investment adviser with the Securities and Exchange Commission pursuant to Section 203(a) of the Investment Advisers Act of 1940, 15 U.S.C. 80b-3(a). The subsidiary would then arrange for the incorporation of a separate investment company, and the new investment company would register its shares with the Commission. See 15 U.S.C. 77e and 77f; see also 15 U.S.C. 80a-8. The investment company then would sell its shares to independent underwriters, who at their own risk would resell the shares in a public offering.[2] Thus, neither the bank holding company nor its investment advisory subsidiary would have any involvement in any promotional activities incident to public distribution of the investment company's shares.

Following the investment company's sale of its securities to the underwriters, the relationship of the bank holding company and its subsidiaries to the investment

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[2] Neither the bank holding company nor any of its subsidiaries could serve as the underwriters. The Board's interpretive ruling expressly prohibits bank holding companies and their subsidiaries from engaging "directly or indirectly, in the sale or distribution of securities" issued by an investment company advisee. 12 C.F.R. 225.125(h). The underwriting must therefore be performed by an independent investment banking firm, as it was in each of the instances cited by respondent (Br. 17-18) in which banking organizations have managed closed-end investment companies. The registration statements of those investment companies confirm that their securities were distributed to the public by independent underwriters, not by banking organizations. See the Appendix attached to this brief.

company would be limited to investment advisory services, *i.e.*, portfolio management and related administrative services, the same services provided to any other investment company by its investment adviser. The investment company would even be free to replace the investment advisory subsidiary with a new investment adviser. 15 U.S.C. 80a-15(a), (c).

In sum, a bank holding company "organizes" or "sponsors" a closed-end investment company simply by participating in the initial establishment of the investment company. At no time during that process is the bank holding company or its bank or nonbank subsidiaries a promoter of, or at risk with respect to, the investment company's securities. In particular, the Board's regulation forbids promotional, speculative, and lending activity that could imperil the financial soundness of any bank subsidiary. See 12 C.F.R. 225.125(f)-(i). There is no more risk of financial loss, or risk of loss of public confidence, than when a bank organizes and furnishes investment advice to a common trust fund in accordance with traditional banking practice.[3]

b. The statutory framework within which the Board acted in authorizing bank holding companies to sponsor closed-end investment companies is prescribed by the Bank Holding Company Act of 1956, 12 U.S.C. 1841 *et seq.*, and the Banking Act of 1933 (Glass-Steagall Act), ch. 89, 48 Stat. 162. The provisions of these statutes are straightforward, and they clearly distinguish between banks, on the one hand, and bank holding companies and other affiliates of banks, on the other.

Section 4(a) of the Bank Holding Company Act, 12 U.S.C. 1843(a), prohibits a bank holding company and its subsidiaries from engaging in any business other than banking or managing or controlling banks. Section 4(c)(8) of that Act, 12 U.S.C. 1843(c)(8), however, empowers the Board to authorize bank holding companies

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[3] See *Mullane* v. *Central Hanover Bank & Trust Co.*, 339 U.S. 306, 307-309 (1950); 12 C.F.R. 9.18.

and their non-bank subsidiaries also to engage in non-banking activities that the Board determines to be "so closely related to banking or managing or controlling banks as to be a proper incident thereto." It is pursuant to Section 4(c)(8) that the Board promulgated the regulation challenged by respondent in this case.

Respondent's arguments against the Board's regulation, however, center not upon the Bank Holding Company Act but upon Sections 16, 20, and 21 of the Glass-Steagall Act, 12 U.S.C. 24 Seventh, 377, and 378. Of these three provisions, only Section 20 is applicable to bank holding companies. Section 20 prohibits bank "affiliates," including bank holding companies and their nonbank subsidiaries, from "engag[ing] principally in the issue, flotation, underwriting, public sale, or distribution * * * of * * * securities."

Section 21 of the Act does not by its terms apply to bank holding companies. It simply prohibits persons engaged in "the business of receiving deposits," *i.e.*, banking, from engaging at the same time in "the business of issuing, underwriting, selling, or distributing * * * [nongovernmental] securities." Section 16 similarly concerns only banks. It provides that banks may not underwrite any issue of nongovernmental securities and that a bank may purchase and sell securities, other than governmental securities and a limited category of other securities, "solely upon the order, and for the account of, customers, and in no case for its own account."

2. Respondent's opening argument (Br. 13-18) rests on a fundamental misunderstanding of the Board's regulation and the statute under which it was promulgated. Respondent contends that the regulation authorizes banks, as well as bank holding companies and nonbank subsidiaries, to manage closed-end investment companies. But as the Board has clearly stated, the regulation authorizes activities only on the part of bank holding companies and their nonbank subsidiaries (Pet. App. 61a, 67a). The Board's interpretation of its own regulation

is consistent with the Bank Holding Company Act and was properly upheld by the court of appeals (Pet. App. 21a-23a). See *United States* v. *Larionoff*, 431 U.S. 864, 872 (1977) (an agency's interpretation of its own regulation is entitled to "controlling weight" unless plainly erroneous).

The regulation at issue was promulgated by the Board pursuant to Section 4(c)(8) of the Bank Holding Company Act, 12 U.S.C. 1843(c)(8), which empowers the Board to authorize bank holding companies and non-bank subsidiaries—not banks—to engage in activities that the Board determines are "so closely related to banking * * * as to be a proper incident thereto." Section 4(c)(8) does not empower the Board to approve or disapprove any business activities of banks. The authority of a bank to engage in a particular activity is determined by the bank's charter and the statute under which the bank is organized. See *Colorado National Bank* v. *Bedford*, 310 U.S. 41, 48 (1940).[4] As the Board explained (Pet. App. 61a), that authority "does not derive from the Board's regulation; such authority would exist independently of the Board's regulation and its scope is to be determined by a particular bank's primary supervisory agency."

Moreover, the Board's regulation does not purport to authorize activities for banks. The challenged regulation adds investment advisory services to the list of activities that the Board previously had approved for a "bank holding company" (see 12 C.F.R. 225.4(a)). While it is

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[4] The governing statute for national banks is the National Bank Act, 12 U.S.C. 21 *et seq.*; state banks derive their powers under state law. In denying respondent's petition for rescission of the Board's regulation, the Board stated, in its capacity as the federal regulator of state-chartered banks that are members of the Federal Reserve System, that should a state member bank engage in the same activity authorized for a bank holding company by the Board's regulation, such activity would not violate Sections 16 and 21 of the Glass-Steagall Act and would be permissible if consistent with applicable state law. The Board made clear, however, that the regulation at issue in this case does not authorize any activities for banks (Pet. App. 60a-61a, 66a-70a).

true that the interpretive ruling (which prescribes limitations on the activities of bank holding companies serving as investment advisers) defines "bank holding companies" to include "both their bank and nonbank subsidiaries" (12 C.F.R. 225.125(c)), the interpretive ruling does so simply to establish that the *restrictions* set forth in the ruling apply to all companies in the holding company system. The interpretive ruling itself authorizes no activities. As the Board explained, it serves solely to limit the activities that are authorized by the accompanying regulation (see Pet. App. 22a-23a, 61a). The definition of "bank holding companies" thus serves to prevent evasion of the restrictions prescribed by the Board through a shifting of prohibited activities to a subsidiary bank, but neither the definition nor any other aspect of the Board's regulation authorizes banks themselves to engage in any activities.

Respondent's argument to the contrary (Br. 14) appears to rest on the fact that, following promulgation of the Board's regulation, a number of banks have participated in the sponsorship of closed-end investment companies. Those banks did not, however, seek or obtain authorization from the Board. See Pet. App. 22a-23a n.26. As the record in this case shows, the Board has not been asked to grant approval (and could not grant approval) for any bank to serve as an investment adviser to an investment company (R. 2262-2266; Pet. App. 67a n.1).[5]

3. In focusing principally upon the activities of banks rather than bank holding companies and their non-bank

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[5] Of the 10 banking organizations cited by respondent (Br. 17-18), only two are engaged in management of closed-end investment companies pursuant to the Board's regulation. BankAmerica Corporation and Western Bancorporation, which are bank holding companies, currently conduct these activities through non-bank subsidiaries. The registration statements relied on by respondent (Br. 15) do not suggest that any banks have organized or managed closed-end investment companies pursuant to the Board's regulation. See R. 418, 485, 666, 1660, 1767.

subsidiaries, respondent evidently hopes to force this case into the mold of *Investment Company Institute* v. *Camp*, 401 U.S. 617 (1971). But in its eagerness to characterize *Camp* as "controlling authority" (Br. 23), respondent ignores the manifold differences between the two cases.

The issue in *Camp* was whether, under Sections 16 and 21 of the Glass-Steagall Act, a bank could issue and distribute interests in a collective investment fund that was administered internally by the bank and operated in the same manner as an "open-end" investment company or "mutual fund." 401 U.S. at 625. The bank operating the fund was engaged regularly and continuously in issuing and selling units of participation "evidencing an undivided and redeemable interest in the assets of the fund." [6] *Ibid.* Thus, the bank acted as "the underwriter of the fund's units of participation." *Id.* at 622-623, 636-638.

Application of the Glass-Steagall Act to those facts required resolution of only one narrow issue. Section 16 of the Glass-Steagall Act prohibits a bank from underwriting any issue of "securities." Section 21 of the Act similarly prohibits any person engaged in the business of issuing, underwriting, selling, or distributing "securities" from also engaging in deposit banking. Accordingly, the question to be decided in *Camp* was whether "participating interests in * * * a [collective investment] fund are * * * 'securities' within the meaning of the Act." 401 U.S. at 634. After reviewing the legislative history and statutory objectives, this Court determined that "the purposes for which Congress enacted the Glass-Steagall Act leave no room for the conclusion that a participation in a bank investment fund is not a 'security' within the meaning of the Act." *Id.* at 635-636.

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[6] A closed-end investment company is not similar to the commingled managing agency accounts considered in *Camp*. Unlike managing agency accounts, assets are contributed to a closed-end company only at its initial organization and on infrequent occasions thereafter, and cannot be withdrawn except upon liquidation of the company.

This case differs fundamentally from *Camp*. Violations of Sections 16 and 21 of the Glass-Steagall Act were found in *Camp* because the bank itself engaged in public distribution of the fund's securities and in the business of issuing, redeeming, and selling those securities. In contrast, no bank is authorized by the Board's regulation to engage in those activities. Nor is any bank holding company or subsidiary authorized to do so.

The Board has forbidden bank holding companies and their subsidiaries, including banks (see page 6, *supra*), from engaging, "directly or indirectly, in the sale or distribution of securities of any investment company for which [they act] as investment adviser." 12 C.F.R. 225.125(h). Thus, no bank or any other company in the holding company structure may underwrite the shares of an investment company. Nor does any company in the holding company structure otherwise create or maintain a market for the investment company's shares. Neither the bank holding company nor its subsidiaries would issue the shares of the investment company; as a separate corporate entity, the investment company issues its own shares. Moreover, the bank holding company and its subsidiaries are prohibited from buying or selling shares of the investment company for their own accounts. 12 C.F.R. 225.125(g). In short, the Board's regulation does not authorize banks, or bank holding companies, or their non-bank subsidiaries, to engage in any of the activities held unlawful in *Camp*. And because the promotional activities at issue in *Camp* are not present here, the dangers identified in *Camp* as arising when banks engage in such activities are not present either.

4. Resolution of respondent's Glass-Steagall Act challenge to the Board's regulation merely requires this Court to apply the literal terms of Section 20 of the Act, 12 U.S.C. 377, which draws the line between permissible and impermissible securities activities of bank "affiliates." [7]

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[7] Bank holding companies and their non-bank subsidiaries are "affiliates" subject to the restrictions of Section 20. As explained

Section 20 prohibits "affiliates" of banks from "engag-[ing] principally" in the issuance, flotation, underwriting, public sale or distribution of securities.

Respondent has wholly failed to demonstrate how a closed-end investment company advisee may be said to engage "principally" in the issuance or distribution of securities under the Board's regulation. "[A] closed-end investment company typically does not issue shares after its initial organization except at infrequent intervals and does not stand ready to redeem its shares." 12 C.F.R. 225.125(c).[8] Virtually by definition, therefore, such an investment company is not "engaged principally" in the issuance or distribution of securities, which is all that Section 20 prohibits. Moreover, the Board's regulation permits bank holding companies to sponsor and advise only closed-end investment companies that are not "primarily or frequently engaged in the issuance, sale and distribution of securities." 12 C.F.R. 225.125(f).

Similarly, a bank holding company or nonbank subsidiary that manages a closed-end investment company pursuant to the Board's regulation would not violate Sec-

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in our opening brief (Br. 24-27), the Court need not decide whether an investment company advisee is also a bank "affiliate" for purposes of Section 20, since a closed-end investment company operating pursuant to the Board's regulation could not, in any event, infringe the standard prescribed by Section 20.

[8] Respondent argues (Br. 23-32) that there is no meaningful distinction between open-end and closed-end investment companies under Sections 16 and 21 of the Glass-Steagall Act. This argument is completely beside the point, for the distinction is fundamental in applying Section 20 of the Act. A closed-end company issues its shares only infrequently and is therefore not engaged "principally" in the issuance of securities. By contrast, an open-end investment company issues its shares continuously and is properly viewed, under the literal terms of Section 20, as an entity "principally" engaged in securities issuance. See Pet. App. 76a-77a. See also *SEC Report on the Public Policy Implications of Investment Company Growth*, H.R. Rep. No. 2337, 89th Cong., 2d Sess. 41-43 (1966); *SEC Report on Investment Trusts and Investment Companies*, H.R. Doc. No. 707 (Pt. 1), 75th Cong., 3d Sess. 26-27 (1938); *SEC Report of Special Study of Securities Markets*, H.R. Doc. No. 95 (Pt. 4), 88th Cong., 1st Sess. 97 (1963).

tion 20. The adviser, of course, does not issue the investment company's securities, and under the Board's regulation and interpretive ruling the adviser is completely segregated from the underwriting process. Accordingly, the investment adviser's activities, limited by the Board's regulation, cannot be characterized as "principal" engagement in the issuance or distribution of securities.[9] Respondent's contrary interpretation would effectively delete the "engaged principally" standard from the statute, in violation of the elementary principle of statutory interpretation that every phrase in a statute must be given effect. See *Reiter* v. *Sonotone Corp.*, 442 U.S. 330, 339 (1979).[10]

Respondent's argument under Section 20 appears to rest on the claim (Br. 62) that the mere issuance of shares at the outset of the closed-end investment company's business constitutes "engag[ing] principally" in the issuance or underwriting of securities. Respondent asserts that the " 'principal engagement' takes place at the time of the initial offering, when the distribution of the securities is the *only* activity of the entity" (*ibid.*; emphasis in original). This argument is wholly without

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[9] A bank holding company investment adviser may not manage a closed-end investment company that issues shares after its initial organization if this results in the closed-end investment company issuing shares on a frequent basis. 12 C.F.R. 225.125(f). If a bank holding company sought to evade this restriction by converting a closed-end company to an open-end company after its formation, such activity would be subject to supervisory restraint. In any event, as the Board explained (Pet. App. 69a-71a, 78a-79a), respondent's references (Br. 30-31) to such hypothetical questions are not relevant in determining the facial validity of the Board's regulation. Those issues can be addressed in future adjudicatory proceedings in which the Board is called upon to apply the regulation to specific facts.

[10] We also note that the Board's regulation goes substantially further than is required to assure compliance with Section 20. The Board has barred *all* involvement by bank holding companies in the security underwriting and distribution process, and has not limited its prohibition to "principal" engagement in underwriting. 12 C.F.R. 225.125(h).

merit. All corporations issue shares at the outset of business. This is true of banks, bank holding companies, and any bank affiliate organized in corporate form.[11] If respondent's argument were correct, every corporation would be "engaged principally" in the issuance of securities and therefore debarred from affiliation with a bank simply by virtue of its initial issuance of stock. In other words, respondent's argument points to the plainly incorrect conclusion that, contrary to the fundamental premise of Section 20 of the Glass-Steagall Act and Section 4(c)(8) of the Bank Holding Company Act, a bank could not have corporate affiliates of any kind.

5. In apparent recognition of the weakness of its legal position under Section 20 of the Glass-Steagall Act, respondent also argues (Br. 62-69) that a bank holding company that manages a closed-end investment company infringes Section 21 of the Act, 12 U.S.C. 378. Both the court of appeals (Pet. App. 14a-21a) and the Federal Reserve Board (*id.* at 54a-56a) correctly rejected that contention.[12]

Section 21 forbids any "person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing * * * or distributing * * * securities" from engaging "at the same time * * * in the business of receiving deposits * * *." Thus, by its terms, Section 21 applies only to *deposit receiving* institutions (such as banks), and not to bank holding companies or nonbank subsidiaries, which by definition do not engage in the business of receiving deposits.[13]

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[11] Both Congress and this Court have recognized the necessity for maintaining adequate capital in banking organizations. See *Board of Governors* v. *First Lincolnwood Corp.*, 439 U.S. 234, 250-251 (1978).

[12] Respondent does not contend that Section 16 of the Act, 12 U.S.C. 24 Seventh, applies to the activities of bank holding companies. See Pet. App. 21a. Section 16, on its face, applies only to banks.

[13] Senator Glass, the framer of the Act, stated that Section 21 was aimed at investment banking firms that also conducted an

The structure of the Glass-Steagall Act further demonstrates the inapplicability of Section 21 to bank holding companies. Section 20 of the Act specifically governs the securities activities of bank affiliates, and by definition the term "affiliate" includes bank holding companies and their non-bank subsidiaries. 12 U.S.C. 221a(b). Section 20 prescribes restrictions that are less stringent than those contained in Section 21. Thus, Section 20 bars bank affiliates only from engaging "principally" in the issuance or distribution of securities, whereas Section 21 more broadly prohibits banks from engaging at all "in the business of issuing, underwriting, selling, or distributing * * * securities." To apply the more sweeping prohibitions of Section 21 to bank affiliates would override Congress' deliberate choice of the "engaged principally" standard for bank affiliates and would render Section 20 a nullity. As the court below correctly determined, the distinctions drawn by Congress between banks and bank affiliates, and the congressional decision to apply different statutory standards to different entities within the holding company structure, are "convincing evidence that Congress rejected a 'single entity' theory in favor of a more discriminating approach to the problem" (Pet. App. 20a). See also *Board of Governors* v. *Agnew*, 329 U.S. 441, 447-448 (1947).[14]

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in-house deposit banking business. See 77 Cong. Rec. 3730 (1933); Pet. App. 17a-18a n.19.

[14] When Congress has enacted a specific statutory standard governing the securities activities of bank affiliates—as it has in Section 20—there is no need to search for standards in provisions of the Act that deal only with banks. When, however, the Act lacks standards specifically designed to cover the activities of bank affiliates in particular areas, it may be appropriate to extend the application of Glass-Steagall prohibitions to prevent evasion of the Act's purposes. Thus, as respondent notes (Br. 67-68), the Board has applied the requirements of Section 32 of the Glass-Steagall Act, 12 U.S.C. 78, to bank holding companies as well as banks, because the Glass-Steagall Act contains no provision governing management interlocks between bank holding companies and investment banking firms. That interpretation does not suggest that differences in the

Finally, even if Section 21 were applicable to bank holding companies, it would not forbid a bank holding company from sponsoring a closed-end investment company within the limitations prescribed in the Board's regulation. The Board's regulation flatly forbids bank holding companies (as well their bank and nonbank subsidiaries) to engage "in the business of issuing, underwriting, selling, or distributing" the shares of investment companies. See note 10, *supra*. In short, the Board's regulation prescribes a prophylactic rule that prohibits bank holding companies to engage in the same activities that are prohibited to banks under Section 21. See pages 19-20, *infra*.

6. Respondent's arguments throughout appear to proceed from the underlying premise that the Glass-Steagall Act was intended to prohibit banks and bank holding companies from engaging in any form of the "securities" business. This inaccurate premise reveals a fundamental misapprehension of the nature of the limitations imposed by the Glass-Steagall Act.

a. Consistent with the provisions of the Glass-Steagall Act, banks traditionally have engaged in a broad spectrum of securities activities. As noted in our opening brief (at 55-56), banks are extensively involved in the

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separate statutory standards prescribed by Congress to regulate the securities activities of "banks" and "bank affiliates" should be disregarded. Nor is the other Board ruling cited by respondent (Br. 69) inconsistent with the Board's regulation here. That ruling did not hold that a bank holding company or its non-bank subsidiaries should be subjected to the requirements of Section 21 of the Glass-Steagall Act. The activities there involved were those of a non-bank subsidiary, and were properly analyzed by the Board under Section 20 of the Act. The Board concluded, based on the particular facts before it, that the holding company parent and the subsidiary (which provided services only to the holding company) should be considered together in applying Section 20. The result was that the holding company and the subsidiary were found not to be "engaged principally" in the issuance of securities. In sum, none of the Board's prior decisions ignores the differences between the separate Glass-Steagall Act provisions applicable to banks and those applicable to bank affiliates.

business of portfolio management, purchasing and selling securities for fiduciary customers including common trust funds, pension trusts, and managing agency accounts. Banks also purchase and sell large quantities of "investment securities" for their own portfolios (see 12 C.F.R. Part 1), receive securities as collateral for loans, and serve as transfer agents and registrars for the securities of corporate customers. Moreover, Section 16 of the Act, 12 U.S.C. 24 Seventh, permits banks to act as dealers in and underwriters of "obligations of the United States [and] general obligations of any State or of any political subdivision thereof." The Act also leaves banks free to interlock with brokerage firms (see *Board of Governors* v. *Agnew*, *supra*, 329 U.S. at 446; 12 C.F.R. 218.1 n.1). As the Securities and Exchange Commission observed in its *Initial Report on Bank Securities Activities* 1 (Jan. 3, 1977):

> Banks historically have played a major role in securities activities and the securities markets. While the permissible range of bank securities activities was circumscribed by passage of the Glass-Steagall Act in 1933, that Act did not separate the business of commercial banking from all aspects of the securities business. Banks act as underwriters of, and dealers in, U.S. government and municipal securities, manage the investments of others as trustee and agent, and are actively involved in the handling of securities and in the settlement of securities transactions for broker-dealers, institutional customers and others.

Thus, the mere fact that a banking activity involves securities cannot be the touchstone for Glass-Steagall Act purposes. Resort to the specific rules prescribed by Congress is essential to determine if a given activity transcends the bounds of lawfulness.

b. Respondent's generalized arguments about statutory purpose also misconceive the legislative history of the Glass-Steagall Act. That history shows that, while Congress intended to place significant restrictions on certain

securities activities of banks, it recognized the necessity for greater liberality in dealing with bank affiliates.[15]

In contrast to the more stringent provisions applicable to banks (see pages 11-12, *supra*), Section 20 of the Glass-Steagall Act only prohibits affiliates from engaging "principally" in the issuance or underwriting of securities. The adoption of the more flexible standard in Section 20 was not inadvertent. The immediate forerunner of Section 20 (then numbered Section 18) in the Glass bill prohibited banks from having specified relationships with entities "engaged primarily in the business of purchasing, selling, or negotiating securities." S. 4115, 72d Cong., 1st Sess. (1932). That provision was considerably broader than its intended objective, which was the underwriting and speculative activities of bank securities affiliates. See *Operation of the National and Federal Reserve Banking Systems: Hearings on S. 4115 Before the Senate Comm. on Banking and Currency*, 72d Cong., 1st Sess. 190, 231, 267 (1932). With this in mind, Eugene Meyer, then Governor of the Federal Reserve System, criticized the text of proposed Section 18:

> MR. MEYER * * * [I]t is impossible to classify absolutely all affiliates that deal in securities as wicked and vicious.
>
> SENATOR GLASS. We are not classifying all of them and we are not intending to reach all of them. * * *

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[15] There is no support in the legislative history of the Glass-Steagall Act for the argument that Congress meant to forbid banks or bank affiliates from serving as investment advisers to closed-end investment companies. The holding in *Investment Company Institute* v. *Camp*, *supra*, depended on the fact that the bank there in question engaged actively in underwriting securities, not on a general congressional purpose to sever all links between banks and investment companies of all kinds. As noted in our opening brief (at 55), commercial banks managed closed-end investment companies prior to (and after) the enactment of the Glass-Steagall Act. However, there is no indication in the legislative history that organization and management of such entities—as distinguished from investing bank assets in them or underwriting their shares—were meant to be forbidden to banks.

Senate Hearings, *supra*, at 393. Governor Meyer then suggested language more narrowly tailored to the specific legislative objective. He proposed a substitute provision that dealt only with "affiliates," as that term was used in Section 2(b) of the bill, and prohibited banks from affiliating with firms "engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail" of securities. *Id.* at 387-389, 391-394, 416-417. The Committee adopted Governor Meyer's suggestion and his proposal was enacted in Section 20 of the Act.[16]

7. Respondent's arguments under Section 4(c)(8) of the Bank Holding Company Act, 12 U.S.C. 1843(c)(8), are, at bottom, merely repetitions of its contentions under the Glass-Steagall Act. Respondent does not adopt the theories articulated by the court of appeals. Nor does it contest the Board's factual determination that sponsorship of a closed-end investment company is "closely related to banking." Instead, respondent contends (Br. 18-32, 41-44) that, as a matter of law, such sponsorship cannot be considered a "proper incident to banking or managing or controlling banks" under Section 4(c)(8). Respondent's argument that sponsorship of a closed-end

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[16] Respondent plainly errs in asserting (Br. 69-75) that banks ceased sponsorship and management of closed-end investment companies after enactment of the Glass-Steagall Act. The very report that respondent cites shows that banks continued to manage and act as the sponsors of at least 12 closed-end investment companies. *SEC Report on Investment Trusts and Investment Companies*, H.R. Doc. No. 70 (Pt. 2), 76th Cong., 1st Sess. 57-59, 124 (1939). Respondent apparently rules upon the fact that "bank securities affiliates," *i.e.*, bank-affiliated investment banking firms (see *id.* at 57 n.38), are shown as having terminated all sponsorship activities. That occurred, however, not because banks could no longer act as sponsors but because the Glass-Steagall Act, by severing the affiliate relationship between investment banking firms and commercial banks, had effectively eliminated "bank securities affiliates." In fact, Congress was aware of the continued sponsorship of closed-end investment companies by banks, and it explicitly approved the continuation of existing relationships in Section 10(c) of the Investment Company Act of 1940, 15 U.S.C. 80a-10(c).

investment company by a *bank holding company* is impermissible under Section 4(c)(8) rests on the premise that such sponsorship by a *bank* would violate Sections 16 and 21 of the Glass-Steagall Act.

Respondent's fundamental premise—that banks may not manage closed-end investment companies within the restrictions prescribed by the Board—is both irrelevant and erroneous. It is irrelevant because bank holding companies may engage in a broader range of securities activities than banks under both the Glass-Steagall Act and the Bank Holding Company Act. It is erroneous because even banks may manage a closed-end investment company under the restrictions prescribed by the Board without infringing either Section 16 or 21 of the Glass-Steagall Act.

a. Section 4(c)(8) of the Bank Holding Company Act authorizes the Board to grant exemptions from Section 4(a) of the Act, a provision that otherwise would restrict bank holding companies solely to the business "of banking or of managing or controlling banks." Thus, the very purpose of Section 4(c)(8), a purpose that is apparent on the face of the statute, is to empower the Board to permit bank holding companies to engage in activities not permitted to banks. If bank holding companies were limited to the activities of banks, as respondent contends, Section 4(c)(8) would be meaningless.

Congress "fully recogniz[ed] that bank holding companies would be permitted to engage in activities that were precluded to a bank * * *." *Connecticut Bankers Ass'n* v. *Board of Governors*, No. 79-1554 (D.C. Cir. Feb. 7, 1980), slip op. 14. Sections 4(c)(6) and (7) of the Bank Holding Company Act, 12 U.S.C. 1843 (c)(6) and (7), permit bank holding companies to buy and sell equity securities, specifically including the securities of investment companies, for their own accounts, even though banks are barred from doing so by Section 16 of the Glass-Steagall Act.[17] Congress additionally un-

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[17] Moreover, as we demonstrated in our opening brief (at 42-43), Section 4(c)(7) of the Bank Holding Company Act permits a bank

derstood that other nonbanking activities might also be proper activities for bank holding companies; but rather than attempt to catalogue each such activity itself, Congress designated the Board as the "appropriate Federal authority in which decisions concerning the relationship of such activities to banking can be determined in each case on its merits." S. Rep. No. 1095, 84th Cong., 1st Sess. 13 (1955).

Nothing in this statutory delegation requires the Board to restrict bank holding companies solely to activities permissible to banks under the Glass-Steagall Act. Respondent apparently relies upon the "proper incident" standard of Section 4(c)(8). But in deciding whether an activity is a "proper incident" to banking or managing or controlling banks, the Board is simply instructed by Section 4(c)(8) to weigh the advantages and disadvantages to the public that may be expected to result from the conduct by a bank holding company of the activity in question:

> In determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public * * * that outweigh possible adverse effects * * *.[18]

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holding company to acquire an interest, including even a controlling interest, in a publicly held investment company, and Section 4(a)(2) authorizes the holding company to provide management services to all companies in which it has a controlling interest. The conjunction of these two powers allows a much more pervasive involvement in the affairs of the investment company than is contemplated by the regulation at issue in this case.

[18] The "proper incident" standard is to be applied by the Board on a case-by-case basis, in response to specific applications by individual bank holding companies. See *NCNB Corp.* v. *Board of Governors*, 599 F.2d 609, 610-611 (4th Cir. 1979); *Association of Bank Travel Bureaus, Inc.* v. *Board of Governors*, 568 F.2d 549, 551-552 & n.2 (7th Cir. 1978); *Alabama Ass'n of Insurance Agents* v. *Board of Governors*, 533 F.2d 224, 245-246 & n.19 (5th Cir. 1976), modified on other grounds, 558 F.2d 729 (1977), cert. denied,

Respondent's efforts to restrict bank holding companies to the activities permissible for banks not only has no statutory basis, it actually contradicts the Glass-Steagall Act. Respondent's arguments would obliterate the careful distinctions drawn by Congress in the Glass-Steagall Act, which impose different standards on banks and bank affiliates (including bank holding companies). See page 12, *supra*. If, in the Glass-Steagall Act itself, Congress chose not to prohibit bank holding companies from engaging in particular securities activities, then that Act plainly affords no basis for the imposition of such a prohibition through the medium of the Bank Holding Company Act. After all, as respondent repeatedly asserts (Br. 33-41), it has been a continuing theme of the legislative history of the Bank Holding Company Act that that Act neither contracts nor enlarges the prohibitions of the Glass-Steagall Act.

b. In light of the fact that bank holding companies may engage in a broader range of activities than banks, it is not necessary for this Court to consider respondent's argument that the activities authorized by the Board would be unlawful if undertaken by a bank. But the Court nevertheless should not be left with the erroneous impression that banks are restricted in the manner respondent suggests. If a bank otherwise were permitted to engage in such activities by its primary supervisory agency, Sections 16 and 21 of the Glass-Steagall Act, 12 U.S.C. 24 Seventh and 378, would not stand in the way (see note 4, *supra*).

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435 U.S. 904 (1978); *Independent Bankers Ass'n of Georgia* v. *Board of Governors*, 516 F.2d 1206, 1215-1216 & n.29 (D.C. Cir. 1975); *National Courier Ass'n* v. *Board of Governors*, 516 F.2d 1229, 1232-1234 & nn.2 & 4 (D.C. Cir. 1975); *BankAmerica Corp.* v. *Board of Governors*, 491 F.2d 985, 988 (9th Cir. 1974). As this Court recently noted in *Lewis* v. *BT Investment Managers, Inc.*, No. 79-45 (June 9, 1980), slip op. 19-20 n.13, the 1970 amendments to the Bank Holding Company Act were intended to give the Board even "greater discretion" than it previously exercised in discharging such responsibilities.

Section 16 provides that a bank may purchase certain types of securities only for the account of "customers," and not for its "own account." In managing a closed-end investment company within the limitations prescribed by the Board, a bank would not be purchasing and selling securities for its own account. Rather, the bank would engage in securities transactions for the account of and solely with funds provided by shareholders of the investment company. See S. Rep. No. 77, 73d Cong., 1st Sess. 16 (1933); H.R. Rep. No. 742, 74th Cong., 1st Sess. 18 (1935). Nor can it reasonably be contended that the investment company advisee, which is owned entirely by its shareholders, is not a "customer" for purposes of Section 16 simply because a bank initially organized it. Such a theory would prohibit a bank from managing the portfolios of common trust funds organized by the bank. See Pet. App. 62a-63a.[19]

Section 21 provides that banks may not engage "in the business of issuing, underwriting, selling, or distributing * * * securities." A bank serving as an investment adviser, and adhering to the limitations set forth in the Board's regulation and interpretive ruling, would not run afoul of that standard. The bank adviser itself would not issue securities, and since it would not be engaged at all in the underwriting of securities, *a fortiori* it would not be engaged in the "business" of underwriting. See Pet. App. 56a-57a; see also *SEC* v. *Fifth Avenue Coach Lines, Inc.*, 289 F. Supp. 3, 31 (S.D.N.Y. 1968), aff'd, 435 F.2d 510 (2d Cir. 1970).[20]

8. Whereas in *Camp* this Court considered the possible hazards of the activities there at issue as additional reasons for enforcing the Glass-Steagall Act according to its

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[19] Respondent suggests (Br. 25) that Section 16 forbids a bank to receive a fee for serving as a fiduciary. However, the early interpretation of Section 16 relied on by respondent has been rescinded by the Comptroller of the Currency. See *New York Stock Exchange* v. *Smith*, 404 F. Supp. 1091, 1097-1101 (D.D.C. 1975), vacated on ripeness grounds, 562 F.2d 736 (D.C. Cir. 1977).

[20] See note 2, *supra*.

"literal terms" (401 U.S. at 639), respondent here offers a grab-bag of purported dangers as a justification for revising the statutes that Congress actually has written. See Br. 75-82. These "policy" arguments, however, provide no basis for deviating from the express terms of the statutes. *Aaron* v. *SEC*, No. 79-66 (June 2, 1980), slip op. 14-15.[21]

Respondent overlooks the fact that the hypothetical hazards it raises are protected against under the Board's regulation, state law, and the federal securities laws.[22] More fundamentally, the Board is empowered to remedy unsound banking practices that might arise in connection with a bank holding company's management of a closed-end investment company. See 12 U.S.C. 1818(b)(1), (3); see also 12 U.S.C. (Supp. II) 1844(e), 1847(b). And the Board is required by law to guard against "undue concentration of resources" and "unfair competition" in reviewing individual applications filed under Section 4(c)(8). See 12 U.S.C. 1843(c)(8). See also *Lewis* v. *BT Investment Managers, Inc.*, *supra*, slip op. 15 & n.10; Pet. App. 78a-79a.

Beyond this, respondent's arguments about potential hazards are entirely speculative. For example, respondent suggests no reason why a subsidiary bank would make a "rescue loan" to a company that issues securities held in an advisee's investment portfolio. Such a strategy would expose the banking organization to the risk of massive

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[21] Respondent's policy arguments prove too much. Nearly all of them could be raised with equal force with respect to a bank's operation of a trust department. See E. Herman, *Conflicts of Interest: Commercial Bank Trust Departments*, 123-127 (1975).

[22] For example, the Board's regulation prohibits a banking organization from recommending shares of its advisee investment company to persons having a fiduciary relationship with the organization. 12 C.F.R. 225.125(h). The Investment Company Act of 1940 prohibits the "dumping" of unsound assets into the portfolio of an investment company (15 U.S.C. 80a-17), and the SEC is vigilant in protecting against abuses by investment advisers. Misuse of confidential information, of course, is a violation of basic fiduciary principles enforceable under state law.

losses of its own funds, while producing a negligible effect on the advisory fee.[23] Similarly, respondent offers no reason why savings depositors would lose confidence in a bank based on the "poor performance" of the portfolio of an investment company advisee. The assets of the advisee are completely separate from those of depositors. Moreover, the performance of large common trust funds managed by banks is routinely published.[24] Publication of that information has not caused a "run" on any banking institution or otherwise adversely affected its soundness.[25]

In sum, respondent's policy arguments about "hazards" and "conflicts of interest" are entirely conjectural, are blunted by applicable legal safeguards, and in any event provide no basis for redrafting the statutes that Congress has enacted.

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[23] The typical annual fee for advising a closed-end investment company is approximately ½% of the assets of the fund. It is difficult to imagine a "rescue" loan, made in an attempt to avert the bankruptcy of an issuer of securities held in the portfolio of an investment company advisee, that would not involve a potential risk of loss to the lender many times greater than any diminution in the advisory fee. Moreover, even if a bank were subject to temptation to engage in imprudent lending of its own assets in the manner that respondent suggests, that temptation would arise with equal or greater force with respect to fiduciary accounts in the bank's own trust department. Periodic examination of the loan portfolios of banks by their supervisory agencies provide substantial protection against hypothetical abuses of this kind.

[24] Since 1975, information about the securities portfolios of large common trust funds has been disclosed pursuant to the Securities Exchange Act of 1934. See 15 U.S.C. 78m(f); 17 C.F.R. 240.13f-1. Detailed "performance" information is also made public by bank money managers. See *American Banker* 1, 10, 16 (Sept. 2, 1980) (survey of performance of equity funds of bank trustees).

[25] Depositors at most banks today are insured up to $100,000 by the Federal Deposit Insurance Corporation. See 12 U.S.C. 1813(m), as amended by Section 308(a)(1) of Pub. L. No. 96-221, 94 Stat. 147. This insurance was provided by Congress to maintain public confidence in banks that receive deposits.

For the foregoing reasons and the reasons set forth in petitioner's opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

WADE H. MCCREE, JR.
Solicitor General

STEPHEN M. SHAPIRO
Assistant to the Solicitor General

OCTOBER 1980

APPENDIX

For the ten investment companies listed in respondent's brief (at 17-18), the public offerings of the companies' securities were handled by the following independent underwriting firms:

Name of Investment Company	Managing Underwriter(s) of Initial Public Offering
1) Bunker Hill Income Securities, Inc.	Lehman Brothers Incorporated Bache & Co. Incorporated DuPont Walston Incorporated Shearson, Hammill & Co. Incorporated Crowell, Weedon & Co. Sutro & Co. Incorporated
2) Circle Income Shares, Inc.	Goldman, Sachs & Co. Hayden Stone Inc. Thompson & McKinnon Auchincloss Inc. Robert W. Baird & Co. Incorporated
3) Current Income Shares, Inc.	Lehman Brothers Incorporated duPont Glore Forgan Incorporated Walston & Co., Inc. Crowell, Weedon & Co. Rauscher Pierce Securities Corporation Stern, Frank, Meyer & Fox Incorporated Sutro & Co. Incorporated
4) Excelsior Income Shares, Inc.	Kidder, Peabody & Co. Incorporated Bache & Co. Incorporated Clark, Dodge & Co. Incorporated Harris, Upham & Co., Incorporated Walston & Co., Inc.
5) Fort Dearborn Income Securities, Inc.	Salomon Brothers duPont Glore Forgan Incorporated A.G. Becker & Co. Incorporated

Name of Investment Company	Managing Underwriter(s) of Initial Public Offering
6) Hatteras Income Securities, Inc.	Salomon Brothers Hornblower & Weeks-Hemphill Noyes Incorporated J.C. Bradford & Co. Incorporated A.G. Edwards & Sons, Inc. Interstate Securities Corporation The Robinson-Humphrey Company, Inc. Wheat, First Securities, Inc.
7) Independence Square Income Securities, Inc.	Eastman Dillon, Union Securities & Co. Incorporated Loeb, Rhoades & Co.
8) Montgomery Street Income Securities, Inc.	Blyth Eastman Dillon & Co. Incorporated duPont Glore Forgan Incorporated Salomon Brothers Dean Witter & Co. Incorporated
9) Pacific American Income Shares, Inc.	Morgan Stanley & Co. Incorporated E.F. Hutton & Company Inc. Bateman Eichler, Hill Richards Incorporated
10) Vestaur Securities, Inc.	Bache & Co. Incorporated

See R. 544-556, 691-706, 788-800, 864-878, 988-1001, 1063-1074, 1148-1163, 1478-1494, 1801-1810, 2136-2146.

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